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In the Supreme Court of the United States

OCTOBER TERM, 1957

No. 460

HERMAN PASTER, PETITIONER,

v.

COMMISSIONER OF INTERNAL REVENUE

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Eighth Circuit.

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The findings of fact and memorandum opinion of the Tax Court (R. 17-41) are not officially reported. The opinion of the Court of Appeals (Pet. 1a-15a) is reported at 245 F. 2d 381.

JURISDICTION

The judgment of the Court of Appeals was entered June 21, 1957. (Pet. 16a.) The petition for a writ of certiorari was filed on September 14, 1957. The jurisdiction of this Court is invoked under 28 U.S.C., Section 1254 (1).

QUESTION PRESENTED

Taxpayer purportedly created three trusts for the benefit of his wife and two minor sons, respectively, allegedly assigning $10,000 due him from a partnership to each trust, under an alleged oral agreement with the principal partner that the $30,000 should remain in the business, and that the trusts would receive 21 percent of the partnership profits.

The question presented is whether the record warrants the Tax Court's conclusion, affirmed by the court below, that the arrangement was merely a scheme to split the earnings of the taxpayer for income tax purposes among the members of his family, that taxpayer remained the substantial owner of the trust property, and that the income attributed to the trusts was therefore taxable to the taxpayer.

STATUTE AND REGULATIONS INVOLVED

The relevant portions of Section 22 (a) of the Internal Revenue Code of 1939, and Sections 29.22(a)-21(a), (b), (d), (e), (f), 29.166-1(b), and 29.167-1(b) of Treasury Regulations 111 are set forth in the Appendix *infra*, pp. 12-17.

STATEMENT

Prior to 1937, taxpayer was a salesman of novelty equipment. In the first part of 1937 he borrowed money from Taran, his wife's uncle, and attempted to go into a similar business for himself, but the business was failing within a month, at which time Taran took it over and employed taxpayer to run it

for him at $35 a week and 15 percent of the profits. (R. 17-18.)

The business, first known as Mayflower Novelty Company, and later as Mayflower Distributing Company, bought, sold, distributed, and operated coin-operated machines, apparatus, and devices. It kept its books and filed its returns on the basis of a fiscal year ending January 31st. According to the returns, from the time Taran took over the business until January 31, 1946, when taxpayer purchased the company, it was a partnership with Taran, his nephew Nilva, and a trust referred to as "S. H. Taran, J. H. Nilva Trust" as the partners. During part of 1944 and 1945, Taran was in a federal prison. He was not a citizen of the United States. (R. 18-19.)

On December 29, 1942, taxpayer executed three trust agreements for the benefit of his wife and two minor sons respectively, which instruments, except for the named beneficiaries and dates of termination, were identical. Among other provisions, each recited that taxpayer as "Donor" had "transferred, assigned, set over and delivered * * * unto himself and Sam Walzer" [taxpayer's brother-in-law] as trustees a $10,000 interest "in the proceeds due Herman Paster as earnings for services rendered to the Mayflower Novelty Company." The trusts were to terminate on November 18, 1960, in the case of the wife and eldest son, and on August 22, 1962, in the case of the other son. The instruments provided that the trusts were irrevocable, set forth spend-thrift provisions, gave the trustees broad powers over the trust property, and provided that the trustees should

keep and maintain separate books and records covering the trust estate. (R. 19-20.)

About 1939, taxpayer's compensation had been increased to $75 per week and 20 percent of the net profits. On January 31, 1943, the beginning of the three taxable years in issue, Mayflower's books showed that it owed taxpayer $51,511.82 for services, but taxpayer's drawing account showed a debit balance of $17,443.32. The books showed no withdrawal from the amount owed taxpayer of the $30,000 purportedly transferred to taxpayer and Walzer as trustees of the alleged trusts, but there was a debit entry of $30,000 entered in a "Note Payable—H. Paster" account and a $30,000 credit to an account entitled "Note Payable—H. Paster, Sam Walzer Trust" described as "Amt set up as trust investment." (R. 20-21,)

The amounts here in question involve sums of $51,519.81, $33,879.66, and $31,680.28 credited in the three taxable years ending January 31, 1944, 1945, and 1946 to the trusts, based on memoranda or tabulations prepared by Johnson, Mayflower's bookkeeper, on instructions from Taran. (R. 22.) The tabulation for the first taxable year was entitled "Mayflower Distributing Co.—Determination of moneys due others—year 2/1/43-1/31/44," and after Mayflower's "Combined income," together with some limited breakdown thereof, was shown as $245,332.42, the following appeared (R. 21-22):

> In consideration of $10,000.00 invested in business for each of 3 trusts the partnership has agreed to pay 7% of profits to each of trusts in

return the original investment to remain in business & not subject to being withdrawn without consent of partnership

7% due Celia Paster Trust	17,173.27
7% due Donald " "	17,173.27
7% due Eddie " "	17,173.27
21% totals	51,519.81
14% due H. Paster for services rendered	34,346.54
Total Amount due others	85,866.35

Numerous inconsistent entries relating to the trusts and the amounts shown as "moneys due others" for each of the taxable years were recorded on Mayflower's books, and are detailed in the Tax Court's findings. (R. 23-26.) These entries culminated in a closing debit entry on January 31, 1946, of $110,735.41, under the description "Trans to H. Paster draw in exchange for note". (R. 26.)

In keeping its accounts and in the reporting of its income, Mayflower did not treat the sums in question either as in payment to the trusts for the use of money or as distributions of a percentage of profits based on investment, but as selling expenses. (R. 24-25.)

No books were ever set up or maintained for the three trusts purportedly created by taxpayer under the instruments above. Johnson did maintain in pencil and on ruled yellow worksheet paper what he has denominated as a running account for each purported trust. There was one sheet for each such trust and the sheets were kept by Johnson in his desk. According to these sheets, and aside from original cred-

its of $10,000 each, the aggregate of credits up to and including January 31, 1946, was $124,622.73, or $41,540.91 to each sheet. There were a few entries entitled "deductions" described as for federal and state taxes, insurance premiums, payment on stock pool, or for a railway ticket for the wife; and various other entries under the heading "other trust deductions". (R. 26-28.)

According to explanatory symbols, the items entered in the column headed "other trust deductions" represented amounts paid by Mayflower Distributing Company, Paster Distributing Company, and H. Paster personally. Although they appear as indicated on the so-called trust accounts and were possibly provided by or at the instigation of taxpayer, they were not taken into account in arriving at the $110,735.41, the entry closing out the "Note Payable—H. Paster, Sam Walzer Trust" account on Mayflower's books, as having been transferred to taxpayer "in exchange for note.". (R. 28.)

The entries on the three yellow sheets purport to extend through October 31, 1947. On all three sheets the items entered under dates subsequent to January 31, 1946, in the columns headed "other trust deductions," were by symbols shown as having been paid by Mayflower Distributing Company, Paster Distributing Company, Paster Enterprises, and H. Paster personally. There were no entries on any of the sheets designed to show any payments or additions to the purported trusts after January 31, 1946, of profits payments or distributions by Mayflower, its successor, or successors. (R. 28-29.)

Mayflower's returns indicated a loan of $35,000 in the fiscal year 1944, together with substantial interest expense and finance fees in each of the taxable years. (R. 30.)

The Tax Court held (R. 30-41) that the profits of Mayflower credited on its books to the "Note Payable—H. Paster, Sam Walzer Trust" account for each of the three taxable years were income to the taxpayer, and that insofar as the tabulations of money or percentages of profits "due others" purported to show otherwise, they were shams and did not reflect the facts. The Court of Appeals affirmed. (Pet. 1a-15a.)

ARGUMENT

This case presents a factual question which has been decided adversely to taxpayer by both courts below upon evidence which fully supports their decision. Neither a conflict nor any other basis for further review exists.

1. It is axiomatic that a donor who retains command or other economic benefits of ownership of the donated property remains its real owner for purposes of Section 22(a) of the Internal Revenue Code of 1939, Appendix, *infra*, p. 12. *Commissioner* v. *Sunnen*, 333 U.S. 591; *Helvering* v. *Clifford*, 309 U.S. 331; *Harrison* v. *Schaffner*, 312 U.S. 579; *Helvering* v. *Horst*, 311 U.S. 112. Indeed, where as here we are dealing with an intra-family transfer, "special scrutiny" of the arrangement is necessary lest what is in reality but one economic unit be multiplied into two or more by devices which, though valid under state law, are

not conclusive so far as § 22(a) is concerned". *Helvering* v. *Clifford*, *supra*, p. 335. See also *Commissioner* v. *Tower*, 327 U.S. 280, 287-288.

The record unquestionably warrants the Tax Court's conclusion (R. 31-41), sustaining the Commissioner's determination, that taxpayer remained the substantial owner, during the taxable years, of the business funds which he purported to convey to three trusts created by him for his wife and two minor children. The taxpayer named himself and his brother-in-law as trustees; the trust property consisted of an amount owing to taxpayer by a business partnership which he managed and controlled; the entire amount owing was retained and left in the business, subject to taxpayer's dominion and control; there was no written profit-sharing agreement between the trusts and the partnership; and the portions of the business profits ascribed to the trusts were not distributed to the beneficiary, but like the corpus of the trusts were left in the business subject to taxpayer's control. Moreover, various entries made on the books of the partnership, as well as the tax returns, are inconsistent with taxpayer's contention that he relinquished control of the funds allegedly constituting the trust property. The Tax Court was not of course obliged to attach credence to uncorroborated testimony of taxpayer and his bookkeeper regarding the alleged trusts. *Quock Ting* v. *United States*, 140 U.S. 417. After making a painstaking analysis of all the evidence, it pointed out that "from other records and other portions of the testimony" it was impelled to reject taxpayer's conten-

tions (R. 32), and that "even if we should take petitioner's testimony at its face, it would appear that he or his business was making free use" during the taxable years of the monies allegedly transferred in trust (R. 39). Taxpayer's retention of control over the donated funds, to say nothing of other features relied upon by the courts below, furnishes solid evidentiary support for the Tax Court's conclusion that taxpayer remained the substantial owner of the funds.[1] Under familiar rules governing the scope of judicial review of the Tax Court's findings, af-

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[1] In the words of the court below (Pet. 8a, 10a):

> In the instant case taxpayer, from a practical standpoint retained complete control of these so-called trusts. The funds were his; he named himself as trustee together with his brother-in-law; the beneficiaries were members of his family, two of them minors; he in effect, loaned the funds to a partnership of which he had complete control and in doing so contracted with that partnership as to the terms of the loan. In fact, under the terms of the trust instruments he and his co-trustee were given complete control over the trust funds and while the trust instruments provided for termination of the trusts the alleged agreement with the partnership provided that the funds could not be withdrawn without the consent of the partnership. In making this alleged agreement the taxpayer made it impossible for the trusts to terminate without the consent of the partnership and the book entries warranted the Tax Court in concluding that the corpus of these so-called trusts and the income therefrom were treated by taxpayer as belonging to him.
>
> * * * *
>
> In the instant case taxpayer had in effect the same dominion and control over the corpus of these alleged trusts and the income arising therefrom as he had before the trust agreements were executed. * * *

firmance of its decision by the court below was clearly justified, and the concurrent finding of both courts below on the factual issue presented is conclusive here. *Comstock* v. *Group of Investors*, 335 U.S. 211, 214; *Corn Products Co.* v. *Commissioner*, 350 U.S. 46, 51.

2. There is no conflict. Whether the creator of a family trust retains control or other attributes of ownership sufficient to stamp him the true owner of the trust property presents a question of fact in each case. Far from being in discord with *Helvering* v. *Clifford*, 309 U.S. 331, as taxpayer asserts (Pet. 4-6), the decision below is in full accord with that decision. The Tax Court there concluded that the taxpayer-husband remained the substantial owner for tax purposes of property transferred in trust for his wife, and this Court held that its conclusion was entitled to affirmance on appeal. The instant case presents an *a fortiori* situation for treating the taxpayer as the substantial owner of the trust property. Nor is there any conflict with *Blair* v. *Commissioner*, 300 U.S. 5, as taxpayer alleges. (Pet. 6-7.) There the taxpayer, the beneficiary of a trust, had parted with substantial as well as titular ownership of his interest; moreover, the case arose under the statutory provisions dealing with the taxability of trust income to the trustees *vis a vis* the beneficiaries (1939 Code Sections 161-162), and it was held that local law was determinative of the beneficiary's power to assign his interest. The case was distinguished in *Harrison* v. *Schaffner*, 312 U.S. 579, involving an issue comparable to that here presented, wherein this Court

reaffirmed the principles enunciated in *Helvering* v. *Clifford*, *supra*. See also *Helvering* v. *Stuart*, 317 U.S. 154, 161-162.

As for the two Court of Appeals cases relied upon by taxpayer for conflict (Pet. 7-10), they are clearly distinguishable on their facts. Suffice it to note that in each the Tax Court had found that the transferor retained no control or other incidents of ownership over the property, and in each case its conclusion was upheld on appeal.

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted,

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OCTOBER 1957.

APPENDIX

Internal Revenue Code of 1939:

SEC. 22. GROSS INCOME.

(a) *General Definition.*—"Gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service, of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever.

* * *

* * * * *

(26 U.S.C. 1952 ed., Sec. 22.)

Treasury Regulations 111, promulgated under the Internal Revenue Code of 1939:

Sec. 29.22(a)-21 [As added by T.D. 5488, 1946-1 Cum. Bull. 19, and amended by T.D. 5567, 1947-2 Cum. Bull. 9]. *Trust Income Taxable To The Grantor As Substantial Owner Thereof.*—(*a*) *Introduction.*—Income of a trust is taxable to the grantor under section 22(a) although not payable to the grantor himself and not to be applied in satisfaction of his legal obligations if he has retained a control of the trust so complete that he is still in practical effect the owner of its income. (*Helvering* v. *Clifford*, 309 U.S. 331). In the absence of precise guides supplied by an appropriate regulation, the application of this principle to varying and diversified factual situations has led to considerable uncertainty and confusion. The provisions of this section accordingly resolve the present difficulties of application by defining and specifying those factors which demonstrate the

retention by the grantor of such complete control of the trust that he is taxable on the income therefrom under section 22(a). Such factors are set forth in general in paragraph (b) and in detail in paragraphs (c), (d), and (e), below.

(b) *In general.*—In conformity with the principle stated in paragraph (a) above, the income of a trust is attributable to the grantor (except where such income is taxable to the grantor's spouse or former spouse under section 22(k) or 171) if—

(1) the corpus or the income therefrom will or may return after a relatively short term of years (see paragraph (c)):

(2) the beneficial enjoyment of the corpus or the income therefrom is subject to a power of disposition (other than certain excepted powers), whether by revocation, alteration, or otherwise, exercisable by the grantor, or another person lacking a substantial adverse interest in such disposition, or both (see paragraph (d)); or

(3) the corpus or the income therefrom is subject to administrative control, exercisable primarily for the benefit of the grantor (see paragraph (e)).

* * * *

(d) *Power to determine or control beneficial enjoyment of income or corpus.*—Income of a trust is taxable to the grantor where, whatever the duration of the trust, the beneficial enjoyment of the corpus or the income therefrom is subject to a power of disposition (except as provided in section 167(e) and as hereinafter provided in subparagraphs 1 to 4, inclusive), whether by revocation, alteration, or otherwise, exercisable (in any capacity and regardless of whether such exercise is subject to a precedent giving of notice or is limited to some future date) by the grantor, or any person not having a substantial adverse interest in the beneficial

enjoyment of the corpus or income, whichever is subject to the power, or both. * * *

* * * * *

(e) *Administrative control.*—Income of a trust, whatever its duration, is taxable to the grantor where, under the terms of the trust or the circumstances attendant on its operation, administrative control is exercisable primarily for the benefit of the grantor rather than the beneficiaries of the trust. Administrative control is exercisable primarily for the benefit of the grantor where—

(1) a power exercisable by the grantor, or any person not having a substantial adverse interest in its exercise, or both, whether or not in the capacity of trustee, enables the grantor or any person to purchase, exchange or otherwise deal with or dispose of the corpus or the income therefrom for less than an adequate and full consideration in money or money's worth; or

(2) a power exercisable by the grantor, or any person not having a substantial adverse interest in its exercise, or both, whether or not in the capacity of trustee, enables the grantor to borrow the corpus or income, directly or indirectly, without adequate interest in any case, or without adequate security except where a trustee (other than the grantor or spouse living with the grantor) is authorized under a general lending power to make loans without security to the grantor and other persons and corporations upon the same terms and conditions; or

(3) the grantor has directly or indirectly borrowed the corpus or income and has not completely repaid the loan, including any interest, before the beginning of the taxable year; or

(4) any one of the following powers of

administration over the trust corpus or income is exercisable in a nonfiduciary capacity by the grantor, or any person not having a substantial adverse interest in its exercise, or both: a power to vote or direct the voting of stock or other securities, a power to control the investment of the trust funds either by directing investments or reinvestments or by vetoing proposed investments or reinvestments, and a power to reacquire the trust corpus by substituting other property of an equivalent value.

* * * * *

(f) *Limitations of section.*—Despite the limitations of this section, the grantor of a trust directing the payment or application of the income therefrom in satisfaction of the grantor's legal obligations shall continue to be taxable on the income. The grantor may also be taxable on the income of a trust on the ground that such income is attributable to him in a capacity unrelated to dominion and control over the trust as such as defined in subsections (c), (d), and (e) of this section. Thus, the provisions of this section do not affect the principles governing the taxability of future income to the assignor thereof whether or not the assignment is by means of a trust. Nor, for example, do the provisions of this section affect the applicability of section 22(a) to the creator of a family partnership. See further sections 166 and 167.

* * * * *

Sec. 29.166-1 [As amended by T.D. 5488, *supra*]. *Trusts With Respect to the Corpus of Which the Grantor is Regarded as Remaining in Substance the Owner; Taxable Years Beginning Prior to January 1, 1946.*—* * *

(b) *Test of taxability to grantor.*—Section 166 defines with particularity instances in which the grantor is regarded as in substance the owner of the corpus by reason of the fact that

he has retained power to revest the corpus in himself. * * *

* * * * *

But the provisions of section 166 are not to be regarded as excluding from taxation to the grantor the income of other trusts, not specified therein, in which the grantor is, for the purposes of the Internal Revenue Code, similarly regarded as remaining in substance the owner of the corpus. The grantor is regarded as in substance the owner of the corpus, if, in view of the essential nature and purpose of the trust, it is apparent that the grantor has failed to part permanently and definitively with the substantial incidents of ownership in the corpus.

In determining whether the grantor is in substance the owner of the corpus, the Internal Revenue Code has its own standard, which is a substantial one, dependent neither on the niceties of the particular conveyancing device used nor on the technical description which the law of property gives to the estate or interest transferred to the trustees or beneficiaries of the trust. In that determination, among the material factors are: The fact that the corpus is to be returned to the grantor after a specific term; the fact that the corpus is or may be administered in the interest of the grantor; the fact that the anticipated income is being appropriated in advance for the customary expenditures of the grantor or those which he would ordinarily and naturally make; and any other circumstance bearing on the impermanence and indefiniteness with which the grantor has parted with the substantial incidents of ownership in the corpus.

Thus, the grantor is regarded as being in substance the owner of the corpus if, in any case, the trust amounts to no more than an arrangement whereby the grantor, in the ordering of his affairs, finds it expedient to entrust for a period the title to, and custody or management of, certain of his property to a trustee, the income from

such property to be used by the trustee during such period to make those expenditures which the grantor would customarily or ordinarily or naturally make and to which the grantor chooses to commit himself in advance, while the corpus is to be held intact, for return in due course to the grantor. * * *

* * * * *

Sec. 29.167-1. *Trusts in the Income of Which the Grantor Retains an Interest.*—* * *

(b) *Test of taxability to the grantor.*—The test prescribed by the Internal Revenue Code as to the sufficiency of the grantor's retained interest in the trust income, resulting in the taxation of such income to the grantor, is whether he has failed to divest himself, permanently and definitively, of every right which might, by any possibility, enable him to have such income, at some time, distributed to him, either actually or constructively. * * *

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